



**MASSACHUSETTS WATER  
POLLUTION ABATEMENT TRUST**

(A Component Unit of the Commonwealth of Massachusetts)

Financial Statements and Required Supplementary Information

June 30, 2007 and 2006

(With Independent Auditors' Report Thereon)

**MASSACHUSETTS WATER  
POLLUTION ABATEMENT TRUST**  
(A Component Unit of the Commonwealth of Massachusetts)

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## **Independent Auditors' Report**

The Board of Trustees  
Massachusetts Water Pollution Abatement Trust:

We have audited the accompanying financial statements of the Massachusetts Water Pollution Abatement Trust (the Trust), a component unit of the Commonwealth of Massachusetts, as of and for the years ended June 30, 2007 and 2006, as listed in the table of contents. These financial statements are the responsibility of the Trust's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Trust's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Massachusetts Water Pollution Abatement Trust as of June 30, 2007 and 2006, and the changes in its financial position and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

The Management's Discussion and Analysis on pages 3 through 8 is not a required part of the basic financial statements but is supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.



In accordance with *Government Auditing Standards*, we have also issued our report, dated December 18, 2007, on our consideration of the Trust's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

KPMG LLP

December 28, 2007

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Management's Discussion and Analysis

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**Management's Discussion and Analysis**

The following is management's discussion and analysis of the financial position and activities of the Massachusetts Water Pollution Abatement Trust (the Trust), a component unit of the Commonwealth of Massachusetts (the Commonwealth), as of and for the fiscal years ended June 30, 2007 and 2006. This discussion is a narrative overview and analysis of our financial activities and should be read in conjunction with the accompanying financial statements.

**Financial Highlights – Fiscal 2007**

- Assets exceed liabilities by \$1.63 billion, a 6.32% increase over fiscal 2006, at the close of the fiscal year. Included in this number is long-term loans receivable, which increased from \$2.6 billion in fiscal 2006 to \$2.9 billion and long-term debt, which increased from \$2.7 billion to \$2.9 billion in fiscal 2007.
- Net assets increased by \$96.8 million from last year, an increase of 6.32%.
- Operating income increased by \$14.6 million from fiscal 2006, resulting in operating income of \$30.1 million in FY07.
- The statement of cash flows indicates a decrease in cash for the year of \$27.74 million.
- In FY07, the Trust continued to receive Capitalization Grants from the U.S. Environmental Protection Agency for both the Clean Water and Safe Drinking Water programs. The Trust received \$29.7 million from the Clean Water Program and received \$22.0 million in the State Drinking Water Program. The Commonwealth provided a match of \$7.1 million for these federally funded programs. The continued capitalization of the Trust, combined with the Trust's access to the bond market, has allowed the Trust to provide funding to all qualified borrowers.
- The Trust issued \$416.2 million in Series 2006A Refunding Bonds in December 2006 – that advance refunded \$426.8 million of previously issued bonds. This new issue will ultimately reduce the cost of the Trust's debt service by \$41.4 million, or 5.6% on a present value basis, over the next 25 years.
- The Trust also issued \$431.1 million in Series 12 in December 2006. This new issue will be used to finance water pollution abatement and drinking water projects in 70 communities and special districts.

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- The Trust continues to maintain its ratings from all three major rating agencies on our bonds, allowing the Trust to continue to provide funds to communities at the lowest cost possible. The Trust's current ratings are:

<u>Ratings on trust debt</u>	<u>Fitch IBCA</u>	<u>Moody's Investor's Service, Inc.</u>	<u>Standard &amp; Poor's</u>
Pooled Loan Program	AAA	Aaa	AAA
Massachusetts Water Resources Authority (MWRA) Loan Program	AA+ - AAA	Aaa	
New Bedford Loan Program	AA- AAA	Aaa (insured) Aa3 (underlying)	
South Essex Sewerage District Loan Program	AAA	Aaa	

**Financial Highlights – Fiscal 2006**

- Assets exceed liabilities by \$1.5 billion, a 6.8% increase over fiscal 2005, at the close of the fiscal year. Included in this number is loans receivable, which increased from \$2.5 billion in fiscal 2005 to \$2.7 billion in fiscal 2006.
- Net assets increased by \$97.5 million from last year, an increase of 6.8%.
- Operating income increased by \$14.6 million from fiscal 2005, resulting in operating income of \$15.5 million in fiscal 2006.
- The statement of cash flows indicates an increase in cash for the year of \$13.0 million.
- In FY06, the Trust continued to receive its Capitalization Grants from the U.S. Environmental Protection Agency in both the Clean Water and Safe Drinking Water programs. The Trust received \$36.6 million from the Clean Water Program and received \$29.6 million in the State Drinking Water Program. The Commonwealth provided a match of \$7.3 million for these federally funded programs. This has allowed the Trust to continue to expand the base of capital in the Revolving Fund and support the administrative costs without having to rely heavily on the Commonwealth to keep the program viable.
- The Trust continues to maintain its ratings from all three major rating agencies on our bonds, thus allowing the Trust to continue to provide funds to communities at the lowest cost possible. The Trust's current ratings are:

<u>Ratings on trust debt</u>	<u>Fitch IBCA</u>	<u>Moody's Investor's Service, Inc.</u>	<u>Standard &amp; Poor's</u>
Pooled Loan Program	AAA	Aaa	AAA
MWRA Loan Program	AA+ - AAA	Aaa	
New Bedford Loan Program	AA- AAA	Aaa (insured) Aa3 (underlying)	
South Essex Sewerage District Loan Program	AAA	Aaa	

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**Overview of Financial Statements**

The financial section of this report consists of the following parts: management's discussion and analysis (this section), the basic financial statements, and the notes to the financial statements.

The Trust's financial statements are prepared in conformity with U.S. generally accepted accounting principles as applied to government enterprise funds. Under this method of accounting, an economic resources measurement focus and an accrual basis of accounting is used. Revenue is recorded when earned, and expenses are recorded when incurred. The basic financial statements include statements of net assets, statements of revenues, expenses, and changes in net assets, and statements of cash flows. This report also includes notes accompanying the statements to fully explain the activities reported in them.

The statements of net assets present information on the assets and liabilities of the Trust. The difference between the two is net assets. Over time, increases and decreases in net assets may be an indicator of the strength or deterioration of the financial health of the Trust.

The statements of revenues, expenses, and changes in net assets report the operating revenues and expenses and the nonoperating revenues and expenses of the Trust for the fiscal year. The difference – increase or decrease in net assets – then determines the net change in assets for the fiscal year. This change in net assets added to last year's net assets will reconcile to the total net assets for this fiscal year.

The statements of cash flows report activity of cash and cash equivalents during the fiscal year resulting from operating activities, capital and related financing activities, noncapital financing activities, and investing activities. The net result of these activities is reconciled to the cash and cash equivalent balances reported at the end of the fiscal year. This statement is prepared using the direct method of presentation which allows the reader to easily discern the amount of cash received from grantors, borrowers, and financial institutions and how much cash was disbursed to borrowers, suppliers, and bondholders.

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**Financial Analysis of the Trust**

***Net Assets***

The Trust's net assets at June 30, 2007 were approximately \$1.6 billion, a 6.3% increase over the prior year (see Table A-1). Total assets increased 10.3% to \$5.0 billion, and total liabilities increased 12.4% to \$3.4 billion.

**Table A-1**  
**Massachusetts Water Pollution Abatement Trust's Net Assets**

(In thousands)

	<b>2007</b>	<b>2006</b>	<b>2005</b>	<b>Percentage change</b>	
				<b>2007 – 2006</b>	<b>2006 – 2005</b>
Current assets	\$ 561,192	590,011	605,488	(5)%	(3)%
Loans receivable, long term	2,869,044	2,567,513	2,388,370	12	8
Other	1,552,486	1,358,131	1,259,311	14	8
<b>Total assets</b>	<b>\$ 4,982,722</b>	<b>4,515,655</b>	<b>4,253,169</b>	<b>10%</b>	<b>6%</b>
Current liabilities	\$ 215,118	206,975	196,426	4%	5%
Long-term debt	2,953,762	2,682,113	2,502,266	10	7
Other	184,094	93,664	119,105	97	(21)
<b>Total liabilities</b>	<b>\$ 3,352,974</b>	<b>2,982,752</b>	<b>2,817,797</b>	<b>12%</b>	<b>6%</b>
Net assets:					
Restricted	\$ 1,453,152	1,390,493	1,322,417	5%	5%
Unrestricted	176,596	142,410	112,955	24	26
<b>Total net assets</b>	<b>\$ 1,629,748</b>	<b>1,532,903</b>	<b>1,435,372</b>	<b>6%</b>	<b>7%</b>

**Long-Term Debt**

The Trust incurs debt in order to fund communities' construction projects under the Clean Water and Drinking Water programs. This debt is offset by the loans receivable carried on the Trust's statements of net assets, and the debt service requirements of this debt are secured by loan repayments by the borrowers, investment earnings on a debt service reserve fund established for each bond issuance, and Commonwealth "contract assistance" subsidies.



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In FY07, the Trust's total liabilities increased by \$370 million to \$3.4 billion. This increase is the net change in debt due to the issuance of the Pooled Loan Program, Series 12 issue of \$431 million and the retirement of \$122 million of outstanding principal through regular payments to bondholders. In fiscal 2007, the Trust also issued \$416 million in additional bonds to advance refund \$426.8 million of previously issued debt to take advantage of the current low interest rate environment. This refunding will net the Trust \$41.4 million (\$24.0 million net present value) in total cash flow savings over the next 25 years.

**Table A-2**  
**Massachusetts Water Pollution Abatement Trust's Changes in Net Assets**

(In thousands)

	<b>June 30</b>			<b>Percentage change</b>	
	<b>2007</b>	<b>2006</b>	<b>2005</b>	<b>2007-2006</b>	<b>2006-2005</b>
Operating revenues:					
Interest income	\$ 179,345	163,391	170,646	10%	(4)%
Other	5,301	3,674	3,603	44	2
Total operating revenues	184,646	167,065	174,249	11	(4)
Operating expenses:					
Interest expense	129,528	134,079	136,457	(3)	(2)
Grant disbursements	—	—	20,836	—	(100)
Program support	16,602	15,306	13,215	8	16
Other	8,397	2,180	2,888	285	(25)
Total operating expenses	154,527	151,565	173,396	2	(13)
Operating income	30,119	15,500	853	94	1,717
Nonoperating revenues:					
Operating grants	7,853	8,507	10,983	(8)	(23)
Capitalization grants	58,873	73,524	84,269	(20)	(13)
Total nonoperating revenues	66,726	82,031	95,252	(19)	(14)
Change in net assets	96,845	97,531	96,105	(1)	1
Net assets, beginning of year	1,532,903	1,435,372	1,339,267	7	7
Net assets, end of year	\$ 1,629,748	1,532,903	1,435,372	6%	7%

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Operating revenues increased by 11% from 2006 to 2007 as a result of increased interest earnings from loans and increased other income. Interest earnings increased as the Trust's loan portfolio shifted toward loans charging 2%, as required by the Legislature beginning with loans approved in 2002. Also, in 2007 short-term interest rates increased over 2006, increasing earnings on the Trust's cash. Other income increased as a result of a change in policy by the Trust to require borrowers to pay loan origination fees at the time of the first debt service payment rather than financing the cost over the life of the loan. Nonoperating revenues decreased 19% from 2006 to 2007 as a result of a reduced federal appropriation for capitalization grants in 2007.

Operating expenses increased by 2% as a result of increased arbitrage rebate payments, and subsidy payments to the Department of Environmental Protection.

**Loans Receivable**

Subsidized financing has been an important incentive for many communities to undertake water and sewer infrastructure improvement projects. Since the enactment of Chapter 95 of the Acts of 1995, the Trust has been the Commonwealth's primary program to finance such improvements.

The Trust provides funding to communities through low-interest loan programs. The rate for Trust loans is set by statute at 2%, although projects approved prior to 2002 may qualify for a lower rate. The Trust's loan programs are very attractive to borrowers, and the Trust's loan portfolio continues to grow. Loans receivable increased from \$2.6 billion to \$2.9 billion, an increase of 11.7%, in fiscal 2007.

**Future Economic Factors**

In March 2007, the Commonwealth enacted Chapter 27 of the Acts of 2007, which provides \$9.7 million in matching capitalization funds for the Federal Clean Water and Safe Drinking Water programs for the fiscal years of 2007 and 2008. The Trust expects the Governor to file a bill with the Legislature that will provide sufficient funding for fiscal years 2009-2014 in January 2008.

**Requests for Information**

This financial report is intended to provide an overview of the financial picture of the Massachusetts Water Pollution Abatement Trust for those with an interest in the agency. Any further questions regarding any of the information contained within this report may be directed to the Executive Director or the Treasurer at One Ashburton Place, 12th Floor, Boston, MA 02108.

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Statements of Net Assets

June 30, 2007 and 2006

(In thousands)

	<u>2007</u>	<u>2006</u>
Assets:		
Current assets:		
Cash and cash equivalents (note 3)	\$ 254,059	281,797
Short-term investments (note 3)	20,941	25,937
Grants receivable:		
U.S. Environmental Protection Agency	14,898	15,931
Commonwealth of Massachusetts	7,304	10,060
Loans receivable, current (note 5)	174,621	171,382
Accrued interest receivable	89,369	84,904
Total current assets	<u>561,192</u>	<u>590,011</u>
Noncurrent assets:		
Project fund investments (note 3)	181,782	91,672
Loans receivable, long-term (note 5)	2,869,044	2,567,513
Long-term investments (note 3)	1,364,196	1,259,633
Other assets	6,508	6,826
Total noncurrent assets	<u>4,421,530</u>	<u>3,925,644</u>
Total assets	<u>4,982,722</u>	<u>4,515,655</u>
Liabilities:		
Current liabilities:		
Accrued expenses	164	—
Accrued interest payable	54,620	58,993
Current portion:		
Loan commitments and project funds payable	20,941	25,937
Long-term debt (note 6)	139,393	122,045
Total current liabilities	<u>215,118</u>	<u>206,975</u>
Noncurrent liabilities:		
Loan commitments and project funds payable	181,782	91,672
Accrued interest on capital appreciation bonds	2,312	1,992
Long-term debt, net (note 6)	2,953,762	2,682,113
Total noncurrent liabilities	<u>3,137,856</u>	<u>2,775,777</u>
Total liabilities	<u>3,352,974</u>	<u>2,982,752</u>
Net assets:		
Restricted (note 7)	1,449,368	1,386,709
Restricted – contract assistance (note 7)	3,784	3,784
Unrestricted (note 7)	176,596	142,410
Commitments and contingencies (note 8)		
Total net assets	<u>\$ 1,629,748</u>	<u>1,532,903</u>

See accompanying notes to financial statements.

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Statements of Revenues, Expenses, and Changes in Net Assets  
Years ended June 30, 2007 and 2006  
(In thousands)

	<u>2007</u>	<u>2006</u>
Operating revenues:		
Loan servicing fees	\$ 3,914	3,646
Loan origination fees	1,387	28
Interest income	<u>179,345</u>	<u>163,391</u>
Total operating revenues	<u>184,646</u>	<u>167,065</u>
Operating expenses:		
Commonwealth of Massachusetts:		
Department of Environmental Protection – programmatic support costs	16,602	15,306
General and administrative	4,511	1,145
Arbitrage rebate payments	3,886	1,035
Interest expense	<u>129,528</u>	<u>134,079</u>
Total operating expenses	<u>154,527</u>	<u>151,565</u>
Operating income	<u>30,119</u>	<u>15,500</u>
Nonoperating revenue:		
Operating assistance:		
Commonwealth of Massachusetts	7,853	7,853
Contract assistance:		
Commonwealth of Massachusetts (note 7)	—	654
Capitalization grant revenue:		
U.S. Environmental Protection Agency capitalization grants (note 4)	51,767	66,207
Commonwealth of Massachusetts matching grants	<u>7,106</u>	<u>7,317</u>
Total nonoperating revenue	<u>66,726</u>	<u>82,031</u>
Increase in net assets	96,845	97,531
Net assets – beginning of year	<u>1,532,903</u>	<u>1,435,372</u>
Net assets – end of year	<u>\$ 1,629,748</u>	<u>1,532,903</u>

See accompanying notes to financial statements.

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Statements of Cash Flows  
Years ended June 30, 2007 and 2006  
(In thousands)

	<u>2007</u>	<u>2006</u>
Cash flows from operating activities:		
Other cash received from borrowers	\$ 5,301	3,675
Cash paid to vendors	(24,682)	(17,246)
Net cash used in operating activities	<u>(19,381)</u>	<u>(13,571)</u>
Cash flows from capital and related financing activities:		
Proceeds from U.S. Environmental Protection Agency capitalization grants	52,800	64,694
Proceeds from Commonwealth matching capitalization grants	9,863	10,407
Net cash provided by capital and related financing activities	<u>62,663</u>	<u>75,101</u>
Cash flows from noncapital financing activities:		
Bonds proceeds	487,143	304,069
Repayment of bonds	(147,968)	(111,655)
Interest paid	(133,579)	(127,699)
Contract assistance	—	654
Operating assistance from the Commonwealth of Massachusetts	7,853	7,853
Other	—	320
Net cash provided by noncapital financing activities	<u>213,449</u>	<u>73,542</u>
Cash flows from investing activities:		
Loans disbursed to recipients	(441,054)	(380,250)
Cash received from borrowers	171,382	141,954
Purchases of investments	(369,322)	(303,884)
Proceeds from maturities of investments	179,645	264,454
Interest received	174,880	155,650
Net cash used in investing activities	<u>(284,469)</u>	<u>(122,076)</u>
Net (decrease) increase in cash and cash equivalents	(27,738)	12,996
Cash and cash equivalents, beginning of year	281,797	268,801
Cash and cash equivalents, end of year	<u>\$ 254,059</u>	<u>281,797</u>
Reconciliation of operating income to net cash used in operating activities:		
Operating income	\$ 30,119	15,500
Adjustments to reconcile operating income to net cash used in operating activities:		
Reclassification of:		
Interest income	(179,345)	(163,391)
Interest expense	129,528	134,079
Changes in operating assets and liabilities:		
Other assets and liabilities, net	317	241
Net cash used in operating activities	<u>\$ (19,381)</u>	<u>(13,571)</u>
Noncash activity:		
During 2007, the Trust issued \$416.2 million of bonds to advance refund \$426.8 million of outstanding bonds through an “in-substance” defeasance transaction.		

See accompanying notes to financial statements.

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**(1) Organization**

The Massachusetts Water Pollution Abatement Trust (the Trust), a component unit of the Commonwealth of Massachusetts (the Commonwealth), was created by Chapter 275 of the Acts of 1989 of the Commonwealth (the Act) to implement the State Revolving Fund (the SRF) Program for the Commonwealth, contemplated by Title VI of the Federal Clean Water Act (the CWA). The Trust is governed by a board of trustees consisting of the State Treasurer, the Secretary of the Executive Office for Administration and Finance, and the Commissioner of the Department of Environmental Protection (the DEP).

The financial and management activities of the Trust are administered by employees of the State Treasurer's office. The project oversight and direction is provided by the DEP. Certain financial oversight is provided by the Executive Office for Administration and Finance. The Trust commenced operations in June 1990. The long-term goals of the Trust include creating and implementing an SRF program that provides a source of financing for water pollution abatement projects (the projects). Construction of projects on the National Municipal Policy List, the cleanup of Boston Harbor, and the correction of combined sewer overflows are prime focuses for the Federal SRF Program.

The Trust is authorized by the Act to borrow money through the issuance of revenue bonds and to apply the proceeds thereon, together with federal and state capitalization grants and other funds made available to the Trust, to make loans to local governmental units to finance the costs of eligible water pollution abatement projects (the Leveraged Loan Program).

During fiscal 1993, the Legislature enacted an amendment to the Act. This law, Chapter 203 of the Acts of 1992 (Chapter 203), states that all eligible loans made by the Trust can have subsidies that accomplish a grant equivalency of 25%. This amendment further directs that certain projects on the DEP's Intended Use Plan prior to 1992 should receive higher subsidy levels.

Chapter 203 also reduces the total authorization for Commonwealth general obligation bonds for the Trust from \$1.3 billion to \$122 million. State matching funds for the federal SRF and reserve funds for the Commonwealth SRF continue to be funded through a general obligation bond source. However, all subsidy contributions now come from a Commonwealth Contract Assistance Agreement that is provided through the Commonwealth's annual operating budget and cannot exceed \$26 million in any one fiscal year. This has the net effect of reducing authorized Commonwealth debt while still ensuring funding for a perpetual state revolving fund.

During fiscal 1994, the Trust established an Interim Loan Program and a Small Direct Loan Program for local government units' borrowing needs. The Interim Loan Program provides temporary short-term financing to local government units that are to be subsequently refinanced through permanent leveraged loans. The Small Direct Loan Program finances single small projects where leveraged loans would not be financially feasible for the local government units.

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During fiscal 1996, the Commonwealth approved an amendment to Chapter 29C of the General Laws to provide a subsidy or other assistance equivalent to a grant of 50% of the eligible costs of the project financed by the loan. The amendment is applicable for all loans issued after October 1, 1995. This amendment provides additional subsidy levels of up to \$8 million annually.

Amendments to the Federal Safe Drinking Water Act adopted in 1996 provide for the establishment of additional state revolving fund programs to provide financial assistance to various community water systems (including for-profit companies) and not-for-profit noncommunity water systems for expenditures that will facilitate compliance with national drinking water regulations or otherwise advance the health protection objectives of the Safe Drinking Water Act. The Safe Drinking Water Act regulations and other guidance issued by the U.S. Environmental Protection Agency contemplate that state revolving fund programs established in accordance with the Safe Drinking Water Act will operate under terms and conditions substantially similar to programs developed under the Federal CWA. In addition, the amendments to the Safe Drinking Water Act provide Authority for the consolidation of a Safe Drinking Water Act revolving fund with a CWA revolving fund for purposes of investment and the issuance of, and security for, bonds.

During fiscal 1998, the Trust created a new fund to account for the receipts and disbursements in conjunction with the Commonwealth's Title V regulations. The Community Septic Management Program Fund is the recipient of amounts bonded for in the Third Pooled Loan Program Financing on April 29, 1997 and the Fourth Pooled Loan Program Financing on December 9, 1998. It also is used for pass-through assistance payments from the Commonwealth to communities to fund administrative costs in setting up loan programs to homeowners at the community level.

The Enabling Act was amended by the Massachusetts Legislature on April 2, 1998 to authorize the Trust to establish a revolving fund program under the Safe Drinking Water Act.

In fiscal 2000, the State Legislature changed the level of subsidies on Trust loans from the 50% grant equivalency level to a flat 2% interest rate to be charged on loans for new projects beginning with those appearing on the calendar year 2002 intended use plan. This was in order to mitigate increases in contract assistance commitments by the Commonwealth, while the Trust could increase its leveraging ratio from 2:1 to 3:1, increasing funding capacity by 50%.

**(2) Summary of Significant Accounting Policies**

The accounting policies of the Trust conform to U.S. generally accepted accounting principles (GAAP) as applicable to government enterprises. The following is a summary of the Authority's significant accounting policies:

**(a) Basis of Presentation**

The Trust's financial statements are prepared using the economic resources measurement focus and the accrual basis of accounting as specified by the Governmental Accounting Standards Board's requirements for an enterprise fund. Operating revenues and expenses are generated through the

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issuance of loans to local government units within the Commonwealth. All other revenues and expenses are reported as nonoperating revenues and expenses.

Under Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Trust has elected to apply all Financial Accounting Standards Board Statements and Interpretations issued on or before November 30, 1989, except those that conflict with or contradict GASB pronouncements.

**(b) Cash and Cash Equivalents**

The Trust's policy is to treat all highly liquid investments with original maturities of three months or less as cash and cash equivalents.

**(c) Investments**

Investments are carried at fair value. Where applicable, fair values are based upon quotations from national security exchanges.

Under the Massachusetts Water Pollution Abatement Trust Program Resolutions (the Resolutions), as amended and supplemented at various bond sale dates, the Trust must maintain certain investment funds in the Federal SRF Loan Program and Commonwealth SRF Loan Program with U.S. Bank and Wells Fargo Bank (the Trustees). The types of funds held by the Trustees are in the following accounts:

**Equity Accounts** – The Equity Fund consists of cash and cash equivalents that are currently held primarily at the Massachusetts Municipal Depository Trust (MMDT). The Equity Fund comprises of both a federal program account and a Commonwealth program account and can be used for programmatic costs and operating expenses within the Federal SRF Loan Program or Commonwealth SRF Loan Program, as applicable. These funds are derived from: (1) funds drawn by the Trust from federal capitalization grants and Commonwealth matching funds; (2) other amounts paid to the Trust representing financial assistance provided pursuant to the Act for purposes of deposit in the Federal SRF Loan Program; (3) other amounts appropriated to the Trust by the Commonwealth for purposes of the Federal SRF Loan Program or Commonwealth SRF Loan Program; (4) direct loan repayment; (5) interest earnings on investment or deposits of amounts held in the Equity Fund; and (6) amounts transferred from the Debt Service Reserve Fund as a result of loan repayments in accordance with the provisions specified in the Resolutions.

**Interim Loan Accounts** – The Interim Loan Fund has been established to fund temporary loans in anticipation of permanent leveraged borrowings. The source of funds is the Equity Fund.

**Project Accounts** – The Project Funds disburse bond proceeds to borrowers as needed. These funds are restricted by the bond resolutions and are to be applied solely to the payment or



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refinancing of costs associated with the applicable project. When all costs have been paid, any amounts remaining unexpended in the Project Funds can be applied to the repayment of the applicable loan service to bondholders. The monies are derived from semiannual loan repayments, which include payments from borrowers, interest earnings on the Debt Service Reserve Funds, and Commonwealth contract assistance payments.

***Debt Service Reserve Accounts*** – Debt Service Reserve Funds consist of reserve requirements equal to 50% of the principal amount outstanding on Clean Water bonds and 40% on Drinking Water bonds. For bonds issued to finance loans authorized by the 2002 and subsequent “Intended Use Plans”, the debt service reserve fund requirement drops to 33.33% of the outstanding principal. In accordance with each bond resolution, amounts are transferred from the Equity Fund to the particular Debt Service Reserve Funds. Interest earnings on the Debt Service Reserve Funds are transferred to their corresponding Revenue Fund and used for debt service payments.

***Debt Service Accounts*** – Debt Service Funds are used as a pass-through of principal and interest from the Revenue Funds to the bondholders. The Debt Service Funds are also used to hold accrued interest on the bonds to be applied to pay a portion of the interest due on the bonds.

**(d) Capital Assets**

The Trust’s capital asset capitalization policy conforms to the Commonwealth’s threshold of \$15,000. As of June 30, 2007 and 2006, the Trust did not have any capital assets.

**(e) Loan Origination Fees and Costs of Issuance**

Fees received and certain direct costs incurred, relating to the origination of loans, have been deferred and are included with loans receivable in the accompanying balance sheets. Prior to fiscal year 2006, loan origination fees and costs were amortized over the life of the loans. Origination fees charged to leveraged borrowers were capped at the estimated costs of leveraged transactions as proposed in the Trust’s administrative budget and allocated to all borrowers, excluding the Title V program.

Beginning in fiscal year 2007, with the issuance of the Series 11 bonds, the Trust changed its policy to require payment of loan origination fees at the time of the first debt service payment. Costs of issuance related to the bonds are then offset against the amount of loan origination fees charged to borrowers. Remaining costs of issuance, if any, are then amortized over the life of the bonds using the straight-line method.

Costs of issuance relating to the issuance of refunding bonds are amortized over the life of the bonds using the straight-line method.

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**(f) Risk Financing**

The Trust is not insured for casualty, theft, tort claims, or other losses. No amounts have been accrued for such losses as they are not considered material. As discussed in note 1, all financial, management, and project oversight activities are provided by employees of the State Treasurer's Office, DEP, and the Executive Office for Administration and Finance. These employees are covered under the Commonwealth's workers' compensation and group insurance (health) programs. The cost of these programs is allocated to the Trust, through the fringe benefit allocation. As described in note 4, the Trust is allowed to expend up to 4% of the federal capitalization grant on program administration costs; therefore, any costs in excess of this amount will be borne by the Commonwealth. As a result, no liability for workers' compensation or group insurance has been recorded by the Trust.

**(g) Capitalization Grants**

Funding from federal capitalization grants and state matching grants are recorded as nonoperating revenues.

**(h) Other Assets**

Other assets consist principally of the unamortized portion of bond issue costs, which are amortized using the straight-line method over the life of the bonds, and other deferred charges.

**(i) Bond Premium**

Bond Premium, included in long-term debt, is amortized using the straight-line method over the life of the associated bond issue.

**(j) Use of Estimates**

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosure of contingent assets and liabilities, at the date of the financial statements and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates.

**(3) Deposits and Investments**

The Trust complies with GASB Statement No. 40, *Deposit and Investment Risk Disclosures*. Cash, cash equivalents, and investments are separately held by several of the Trust's funds.

**(a) Cash and Cash Equivalents**

The Trust's cash and cash equivalents consist of bond proceeds received and not yet lent as well as project funds that have not yet been disbursed. All but a small portion of these amounts are held by the Trustees and disbursed in accordance with executed loan agreements. A small portion of the cash and cash equivalents are held to pay the administrative costs of the Trust.

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Cash and cash equivalents comprise bank deposits as well as investments in the MMDT, an external investment pool managed by the State Treasurer for cities, towns, and other state and local agencies. For purposes of risk categorization, MMDT shares are not categorized. The fair value of the Trust's position in MMDT is at unit value.

*Custodial Credit Risk – Deposits.* Custodial credit risk for deposits is the risk that, in the event of a bank failure, the Trust's deposits may not be returned to it. The Trust does not have a deposit policy for custodial credit risk.

At the end of the year, carrying amounts of the Trust's deposits were \$0 and \$0, which equaled the bank balances, at June 30, 2007 and 2006, respectively. As of June 30, 2007 and 2006, \$0 and \$0, respectively, of the Trust's deposits was covered by depository insurance and the remainder was exposed to custodial credit risk as uninsured and uncollateralized.

**(b) Investments**

*Custodial Credit Risk – Investments.* Custodial credit risk for investments is the risk that, in the event of a failure of the counterparty, the Trust will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. The Trust does not have an investment policy for custodial credit risk.

The Trust primarily invests in guaranteed investment contracts (GICs), which under GAAP, are not subject to custodial credit disclosure because they are direct contractual investments and are not securities.

*Credit Risk.* The Trust has not adopted a formal policy related to credit risk. Although GICs are typically not rated, the GIC issuers are all rated AAA or AA. All GIC issuers that are rated lower than AAA are fully collateralized at 105% with U.S. Treasury securities or government-backed agency notes. MMDT is not rated.

The fair value and maturities of the Trust's investment are presented below (in thousands):

Investment type	Fair value		Investment maturities (in years)			
	2006	2007	Less than 1	1 to 5	6 to 10	More than 10
Debt securities:						
Guaranteed investment contracts	\$ 1,377,242	1,566,919	84,820	498,520	387,606	595,972
Cash equivalent:						
Massachusetts Municipal Depository Trust (MMDT)	281,797	254,059				
Total investments	\$ 1,659,039	1,820,978				

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*Concentration of Credit Risk.* Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. The Trust places no limit on the amount that may be invested in any one issuer. More than 4% of the Trust's total investments are with the following issuers:

	<b><u>Percent of total investments</u></b>
Issuer:	
FSA Capital Management Services, LLC	29%
IXIS Funding Corp.	29
Trinity Funding Company, LLC	16
Société Générale	4

*Interest Rate Risk.* The Trust does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair-value losses arising from increasing interest rates.

**(4) Capitalization Grants**

The operating agreements for the federal capitalization grants require that the Trust enter into binding commitments with local government units within one year of the receipt of each federal grant payment to provide assistance in an amount equal to 120% (including 20% state matching grants) of each federal capitalization grant. Federal grant payments are received by the Trust in the form of an automated clearing house account. For financial statement purposes, federal capitalization grants and the 20% state matching grants has been recognized in the Federally Capitalized SRF for the amount of executed loan agreements and binding commitments.

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The Federal Safe Drinking Water Program and the Federally Capitalized Community Hardship Loan Program have different allocation percentages. For the Federal Safe Drinking Water Program, each grant year has a different allocation based on the amount of federal “set-asides” used. An additional 20% or \$5.9 million was matched from required state matching funds already on hand at the Trust. All draws for project costs and for reserve funding must maintain this proportionality under the Federal Safe Drinking Water Act. On a cash basis; for 2007 and 2006, the proportionality is determined as follows (in thousands):

<b>Clean water program</b>	<b>Fiscal year</b>	
	<b>2007</b>	<b>2006</b>
Federal capitalization	\$ 29,731	36,586
State match on federal funds (20%)	5,946	7,317
Total capitalization	35,677	43,903
Less federally mandated “set-asides”	(1,427)	(1,756)
Project capitalization	\$ 34,250	42,147
Federal proportionality	80%	80%
State proportionality	20	20

  

<b>Drinking water program</b>	<b>Fiscal year</b>	
	<b>2007</b>	<b>2006</b>
Federal capitalization	\$ 22,036	29,621
State match on federal funds (20%)	4,407	5,924
Total capitalization	26,443	35,545
Less federally mandated “set-asides”	(6,831)	(6,227)
Project capitalization	\$ 19,612	29,318
Federal proportionality	80%	80%
State proportionality	20	20

The Clean Water State Revolving Fund Loan Program is unchanged from previous years. The total federal award and the state matching funds of 20% are reduced by 4% for an administrative allowance. The total amount available for financing is net of this allowance.

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**(5) Loans Receivable and Bonds Purchased**

The Trust issued a total of 90 and 97 loan or bond purchase agreements during fiscal 2007 and 2006, respectively. Additionally, 14 and 45 loans were disbursed under the Community Septic Management Program Fund in 2007 and 2006, respectively. Pursuant to agreements with the EPA, bond purchase agreements are used for extended financing with terms beyond 20 years. In 2007, 8 of the 90 agreements issued were issued as 30-year bond purchase agreements to the towns of Fall River, Holyoke, Kingston, Millbury, Newbury, Newburyport, and Upper Blackstone Water Pollution Abatement District and the Massachusetts Water Resources Authority (MWRA), for a total of \$168.7 million.

A summary of these receivables as of June 30, 2007 and 2006 is as follows (amounts in thousands):

	<u>2007</u>	<u>2006</u>
Leveraged loans or bonds purchased	\$ 3,009,062	2,692,350
Direct loans	50	69
Interim loans	<u>34,553</u>	<u>46,476</u>
	3,043,665	2,738,895
Current portion	<u>174,621</u>	<u>171,382</u>
Long-term portion	<u>\$ 2,869,044</u>	<u>2,567,513</u>

Aggregate principal maturities on loans receivable or bonds purchased are as follows (amounts in thousands):

2008	\$ 139,393
2009	142,573
2010	147,880
2011	151,055
2012	153,011
Thereafter	<u>2,275,150</u>
	<u>\$ 3,009,062</u>

Interim loans of \$34,538,344 and direct loans of \$16,500 also mature in 2008.

Subsidy payments to be applied to repayments from borrowers include interest earnings provided by Debt Service Reserve Funds and contract assistance provided to the Trust by the Commonwealth. Both of these subsidies are expected to be available for the lives of the financing agreements. For the leveraged bond purchase program, pursuant to an agreement with the Commonwealth, subsidies are drawn in an amount as if the financing was for a twenty-year period. The amount that is not currently needed is invested at the applicable bond yield until funds are needed for subsidies beyond year 20, similar to an annuity. If subsidy funds are not available, the obligation of the borrower is increased by such shortfall.

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The agreement requires the borrower to pay the Trust an annual or semiannual servicing fee equal to 0.15% or 0.075%, respectively, of the principal obligation outstanding on the applicable date. As of June 30, 2007, all borrowers have opted for the semiannual payment schedule. None of these fees are capitalized as part of a borrower's obligation to the Trust.

**(6) Bonds Payable**

The following is a summary of bonds payable at June 30, 2007 and 2006 (in thousands):

	<u>Beginning balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending balance</u>	<u>Due within one year</u>
Water Pollution Abatement					
Revenue Bonds:					
MWRA Loan Program:					
Series 1993A, 4.5% to 5.45%, issued March 18, 1993, due 2000 to 2013	\$ 5,375	—	1,090	4,285	980
Series 1993B, 4.3% to 5.25%, issued January 6, 1994, due 2000 to 2014	4,660	—	735	3,925	690
Series 1995A, 4.5% to 6.0%, issued November 21, 1995, due 2000 to 2015	5,720	—	835	4,885	795
Series 1998A, 4.0% to 5.375%, issued July 9, 1998, due 2000 to 2018	11,665	—	1,280	10,385	1,250
Series 2002A, 3.0% to 5.25%, issued October 15, 2002, due 2003 to 2032	88,280	—	34,240	54,040	3,455
South Essex Sewage District					
Loan Program:					
Series 1994A, 5.3% to 6.375%, issued November 1, 1994, due 2001 to 2015	6,265	—	1,025	5,240	965
Series 1996A, 4.25% to 6.0%, issued December 5, 1996, due 2000 to 2016	7,360	—	955	6,405	905
New Bedford Loan Program:					
Series 1996A, 4.8% to 6.0%, issued July 10, 1996, due 2000 to 2016	10,340	—	1,570	8,770	1,490
Pool Loan Program:					
Series 1, 4.75% to 5.6%, issued July 14, 1993, due 2000 to 2013	21,850	—	20,558	1,292	323

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	<u>Beginning balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending balance</u>	<u>Due within one year</u>
Series 2, 4.9% to 6.125%, issued June 1, 1995, due 2001 to 2015	\$ 7,345	—	2,460	4,885	2,610
Series 3, 4.6% to 6.0%, issued April 29, 1997, due 2001 to 2017	26,465	—	7,070	19,395	6,625
Series 4, 4.0% to 5.125%, issued December 9, 1998, due 2000 to 2018	43,180	—	7,800	35,380	8,015
Series 5, 4.25% to 5.75%, issued October 6, 1999, due 2000 to 2029	82,960	—	11,610	71,350	11,925
Series 6, 4.5% to 5.66%, issued November 6, 2000, due 2001 to 2030	121,400	—	14,245	107,155	14,645
Series 7, 3.0% to 5.25%, issued July 15, 2001, due 2001 to 2021	218,680	—	13,115	205,565	13,770
Series 8, 3.0% to 5.0%, issued November 15, 2002, due 2003 to 2032	133,530	—	10,085	123,445	10,285
Series 9, 2.0% to 5.0%, issued October 10, 2003, due 2004 to 2033	290,825	—	150,435	140,390	11,075
Series 10, 2.5% to 5.25%, issued August 25, 2004, due 2005 to 2028	307,030	—	178,910	128,120	10,680
Series 11, 3.0% to 5.25%, issued October 19, 2005, due 2006 to 2029	293,760	—	94,955	198,805	12,360
Series 12, 3.0% to 5.25%, issued December 14, 2006, due 2007 to 2030	—	431,050	—	431,050	11,860
Subordinated Revenue					
Refunding Bonds:					
New Bedford Loan Program:					
Series 1998A, 4.0% to 5.25%, issued December 23, 1998, due 2001 to 2026	107,920	—	2,940	104,980	3,135
MWRA Loan Program:					
Series 1999A, 4.2% to 6.0%, issued November 3, 1999, due 2000 to 2029	292,850	—	9,845	283,005	10,555



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	<u>Beginning balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending balance</u>	<u>Due within one year</u>
Pool Program Refunding:					
Series A and B, 2.0% to 5.25%, issued August 25, 2004, due 2005 to 2028	\$ 644,660	—	980	643,680	1,000
Pool Program Refunding:					
Series 2006, 3.0% to 5.25%, issued December 14, 2006 due 2007 to 2030	—	416,235	8,020	408,215	—
Subtotal	2,732,120	847,285	574,758	3,004,647	139,393
Less unamortized amounts:					
Bond premium	120,749	56,093	19,588	157,254	—
Net unamortized excess of reacquisition price over net carrying value of defeased bonds	(48,711)	(22,755)	(2,720)	(68,746)	—
Total bonds payable	<u>\$ 2,804,158</u>	<u>880,623</u>	<u>591,626</u>	<u>3,093,155</u>	<u>139,393</u>

The following is a summary of bonds payable at June 30, 2006 and 2005 (in thousands):

	<u>Beginning balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending balance</u>	<u>Due within one year</u>
Water Pollution Abatement Revenue Bonds:					
MWRA Loan Program:					
Series 1993A, 4.5% to 5.45%, issued March 18, 1993, due 2000 to 2013	\$ 6,565	—	1,190	5,375	1,090
Series 1993B, 4.3% to 5.25%, issued January 6, 1994, due 2000 to 2014	5,430	—	770	4,660	735
Series 1995A, 4.5% to 6.0%, issued November 21, 1995, due 2000 to 2015	6,580	—	860	5,720	835
Series 1998A, 4.0% to 5.375%, issued July 9, 1998, due 2000 to 2018	12,970	—	1,305	11,665	1,280
Series 2002A, 3.0% to 5.25%, issued October 15, 2002, due 2003 to 2032	91,550	—	3,270	88,280	3,365

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	<u>Beginning balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending balance</u>	<u>Due within one year</u>
South Essex Sewage District					
Loan Program:					
Series 1994A, 5.3% to 6.375%, issued November 1, 1994, due 2001 to 2015	\$ 7,340	—	1,075	6,265	1,025
Series 1996A, 4.25% to 6.0%, issued December 5, 1996, due 2000 to 2016	8,365	—	1,005	7,360	955
 New Bedford Loan Program:					
Series 1996A, 4.8% to 6.0%, issued July 10, 1996, due 2000 to 2016	11,985	—	1,645	10,340	1,570
 Pool Loan Program:					
Series 1, 4.75% to 5.6%, issued July 14, 1993, due 2000 to 2013	25,270	—	3,420	21,850	2,655
Series 2, 4.9% to 6.125%, issued June 1, 1995, due 2001 to 2015	9,680	—	2,335	7,345	2,460
Series 3, 4.6% to 6.0%, issued April 29, 1997, due 2001 to 2017	33,310	—	6,845	26,465	7,070
Series 4, 4.0% to 5.125%, issued December 9, 1998, due 2000 to 2018	50,800	—	7,620	43,180	7,800
Series 5, 4.25% to 5.75%, issued October 6, 1999, due 2000 to 2029	94,300	—	11,340	82,960	11,610
Series 6, 4.5% to 5.66%, issued November 6, 2000, due 2001 to 2030	135,290	—	13,890	121,400	14,245
Series 7, 3.0% to 5.25%, issued July 15, 2001, due 2001 to 2021	230,305	—	11,625	218,680	13,115
Series 8, 3.0% to 5.0%, issued November 15, 2002, due 2003 to 2032	143,455	—	9,925	133,530	10,085
Series 9, 2.0% to 5.0%, issued October 10, 2003, due 2004 to 2033	301,265	—	10,440	290,825	10,875
Series 10, 2.5% to 5.25%, issued August 25, 2004, due 2005 to 2028	317,175	—	10,145	307,030	10,290
Series 11, 3.0% to 5.25%, issued October 19, 2005, due 2006 to 2029	—	293,760	—	293,760	7,220

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	<u>Beginning balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending balance</u>	<u>Due within one year</u>
Subordinated Revenue					
Refunding Bonds:					
New Bedford Loan Program:					
Series 1998A, 4.0% to 5.25%, issued December 23, 1998, due 2001 to 2026	\$ 110,675	—	2,755	107,920	2,940
MWRA Loan Program:					
Series 1999A, 4.2% to 6.0%, issued November 3, 1999, due 2000 to 2029	302,085	—	9,235	292,850	9,845
Pool Program Refunding:					
Series A and B, 2.0% to 5.25%, issued August 25, 2004, due 2005 to 2028	645,620	—	960	644,660	980
Subtotal	2,550,015	293,760	111,655	2,732,120	122,045
Less unamortized amounts:					
Bond premium	114,860	10,309	4,420	120,749	—
Net unamortized excess of reacquisition price over net carrying value of defeased bonds	(50,954)	—	(2,243)	(48,711)	—
Total bonds payable	\$ <u>2,613,921</u>	<u>304,069</u>	<u>113,832</u>	<u>2,804,158</u>	<u>122,045</u>

All bonds are payable from amounts pledged pursuant to the Water Pollution Abatement Project Bond Resolutions, which include payments by the local governmental units of principal and interest on the loans and amounts on deposit in the Debt Service Reserve Funds. Pursuant to the Commonwealth Assistance Contract (the Contract), the Commonwealth has agreed to provide Contract Assistance payments to the Trust to reduce the payments by local governmental units. The Contract is not pledged as security for the bonds; however, the Contract Assistance payments, when received by the Trust, are pledged as security for the bonds.

In December 2006, the Trust issued \$431.1 million in new bonds with its Pool Program Series 12. These monies were used to finance water pollution abatement and drinking water projects in 70 communities and special districts.

In December 2006, the Trust issued \$416.2 million in refunding bonds (at a true interest cost of 4.03%) as a partial advanced refunding of several previous Trust bond issues. The issues that were partially refunded were Pool Program Series 9, 10, and 11 and MWRA Loan Program Series 2002A. The total debt defeased through this new issue was \$426.8 million, for a cash flow savings of \$41.4 million, and an economic gain (net present value) of \$24 million.

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All issuance costs of the transaction were paid from bond proceeds, and the required debt service reserves were invested in GICs. The remaining proceeds were deposited with an escrow agent to provide resources for all future debt service payments on the refunded bonds. As a result, the refunded bonds are considered to be defeased and the liability has been removed from the financial statements. The reacquisition price exceeded the net carrying amount of the old debt by \$22.8 million, which is being netted against the new debt issued.

In November 2005, the Trust issued \$293.8 million in new bonds with its Pool Program Series 11. These monies were used to finance water pollution abatement and drinking water projects in 55 communities and special districts.

	<b>Total debt service</b>	<b>Principal</b>	<b>Interest</b>
Year ending June 30:			
2008	\$ 286,323	139,393	146,930
2009	280,935	142,574	138,361
2010	279,804	147,880	131,924
2011	276,255	151,055	125,200
2012	271,319	153,012	118,307
2013 – 2017	1,278,271	798,423	479,848
2018 – 2022	995,498	721,675	273,823
2023 – 2027	591,318	471,495	119,823
2028 – 2032	234,933	191,890	43,043
2033 – 2037	94,824	87,250	7,574
	<u>\$ 4,589,480</u>	<u>3,004,647</u>	<u>1,584,833</u>

The balances of bonds defeased “in-substance” in prior years and still outstanding as of June 30 are as follows (amounts in thousands):

<b>Description</b>	<b>Redemption date</b>	<b>Outstanding principal amount</b>	
		<b>2007</b>	<b>2006</b>
MWRA Loan Program:			
Series 1993A	November 3, 1999 \$	52,380	59,910
Series 1993B	November 3, 1999	39,445	42,990
Series 1995A	November 3, 1999	43,730	47,015
Series 1998A	November 3, 1999	79,760	83,385
Series 1999A	August 25, 2004	57,705	57,705
Series 2002A	August 25, 2004	26,980	26,980
Series 2002A	December 14, 2006	43,360	—

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Description	Redemption date	Outstanding principal amount	
		2007	2006
New Bedford Loan Program:			
Series 1996A	December 23, 1998	\$ 71,560	77,660
South Essex Sewage District			
Loan Program:			
Series 1996A	July 15, 2001	41,920	45,060
Pool Loan Program:			
Pool 2	July 15, 2001	20,720	20,720
Pool 3	July 15, 2001	51,695	51,695
Pool 4	August 25, 2004	63,765	63,765
Pool 5	August 25, 2004	125,240	125,240
Pool 6	August 25, 2004	154,850	154,850
Pool 7	August 25, 2004	59,330	59,330
Pool 8	August 25, 2004	105,045	105,045
Pool 9	December 14, 2006	156,270	—
Pool 10	December 14, 2006	184,725	—
Pool 11	December 14, 2006	89,325	—

**(7) Net Assets**

As of June 30, 2007 and 2006, the Trust has restricted net assets in the amount of \$1.453 billion and \$1.390 billion, respectively, and unrestricted net assets in the amount of \$176.596 million and \$142.410 million, respectively. Restricted net assets represent capitalization grants received cumulative to date from the U.S. Environmental Protection Agency and corresponding matching amounts received from the Commonwealth. The capitalization grants are restricted to provide financial assistance, but not grants, to local communities and interstate agencies for the construction of wastewater treatment works, drinking water infrastructure improvements, and other related projects as described in note 1.

**(8) Commitment**

As of June 30, 2007 and 2006, the Trust has agreed to provide loans to various local government units amounting to approximately \$23.1 million and \$64.7 million, respectively, excluding loans to be disbursed, which will be funded or collateralized with grant awards received by the Trust.

**(9) Derivative Transactions**

**(a) Interest Rate Swap Forward Agreement: \$194,825,000 dated May 23, 2007**

*Objective of the interest rate swap* – The objective of the swap is to hedge market risk associated with the current refunding of \$185,450,000 in MWRA Series 1999A bonds on August 1, 2009. If these bonds were available to be refunded with fixed rate bonds on the date of the swap, the Trust would have been able to reduce its overall debt service by \$12.0 million dollars, or 6.5% on a net present value basis, and would have reduced the debt service of the MWRA by \$7.9 million. Legally,

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however, these bonds cannot be advance refunded, and can only be refunded on their call date, August 1, 2009. This interest rate swap hedges market risk until the call date, locking in net present value savings of 5.6% if cash settled, or 7.0% if executed.

*Terms* – The Effective Date is August 1, 2009. The Termination Date, if the swap is executed on the Effective Date, is August 1, 2029. Otherwise, the Termination Date is August 1, 2009. The notional amount is \$194,825,000. The Applicable Notional Amount declines from the Notional Amount to zero from the Effective Date to the Termination Date on a schedule that effectively allows the Trust to make level payments for the term of the agreement. The counterparty is MLCS.

If the Trust elects to execute the swap on the Effective Date, under the swap the Trust pays the counterparty, MLCS, a fixed payment of 4.102% and receives a variable payment of USD-SIFMA Municipal Swap Index on the Applicable Notional Amount.

*Fair value* – As of June 30, 2007, the approximate fair market value of this swap is positive \$1.010 million. It is the Trust's policy to disclose the dealer's valuation and to verify the valuation using a swap advisor. This valuation was calculated using the zero-coupon method. This method calculates the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement of the swap.

*Credit risk* – As of June 30, 2007, the Trust was exposed to credit risk because the swap carried a positive valuation of \$1.010 million. The swap counterparty was rated AA-/Aa3/AA- by Standard & Poor's, Moody's Investors Service, and Fitch Ratings, respectively, but has subsequently been downgraded to A+/A1/A+. To mitigate credit risk, the Trust has the right to terminate at any time, including upon ratings downgrade by the counterparty.

*Basis risk* – As of June 30, 2007, the Trust was not exposed to basis risk, as this transaction is not effective until August 1, 2009. After the Effective Date, if the Trust chooses to execute the swap, the Trust will be exposed to basis risk to the extent that the USD-SIFMA Municipal Swap Index differs from the variable rate on the bonds to be issued by the Trust. At that time, it is the Trust's intention to mitigate the potential for basis risk through the funding of a reserve fund or allocating excess cash flows to the swap payment.

*Termination risk* – The swap contract uses the International Swap Dealers Association Master Agreement, which includes standard termination events, such as failure to pay and bankruptcy. In addition, the Trade Confirmation stipulates that the swap automatically terminates on the Effective Date, or will be executed upon the Trust's option. It further stipulates that the Trust and counterparty may designate an Early Termination Date at any time. The Trust and the counterparty may terminate if either party fails to perform under the terms of the Contract. If at the time of termination, the swap has a negative fair value, the Trust would be liable to the counterparty for a payment equal to the swap's fair value. The source of funds for this payment may be from refunding bond proceeds or from "legally available funds." Legally available funds is defined as, "funds held in the Trusts

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Federal Clean Water State Revolving Fund or Drinking Water State Revolving Fund...only to the extent that Congress passes a law or EPA adopts a regulation or issues an opinion or other notice...making such amounts legally available to pay settlement amounts..."

*Swap payments and associated debt.* As of June 30, 2007, the swap had not reached its Effective Date. The Trust is liable for no swap payments at this time.

If the Trust executes the swap transaction and issues variable rate bonds on or before August 1, 2009, using interest rates as of June 30, 2007 (assume this interest rate remains the same for the term), the total savings over the term would be \$19.3 million (\$12.9 million net present value).

**(b) Interest Rate Swap Agreements: \$77,255,000 dated November 21, 2006**

*Objective of the interest rate swap* – The objective of the swap is to reduce the Trust's borrowing costs by comparison to the issuance of fixed rate bonds at the time of issuance in December 2006. The Trust entered into two swap agreements, under the same terms, to create "synthetic fixed rate" bonds for maturing in 2022 and 2023.

*Terms* – Under the terms of these swaps, the Trust agrees to receive a variable rate, based on the Consumer Price Index, equal to the amounts due on variable rate bonds issued by the Trust concurrently with the execution of the swap agreement. The Trust agrees to pay a fixed rate to the counterparty. Payments are made semiannually, due August 1 and February 1 of each year, on the same schedule as the fixed rate bonds issued in December 2006. The counterparty is Bear Stearns Capital Markets, Inc. The terms of each swap agreement are summarized below:

	<u>2022 Termination</u>	<u>2023 Termination</u>
Trade date	November 21, 2006	November 21, 2006
Effective date	December 14, 2006	December 14, 2006
Variable rate bond coupon payments	CPI + 0.99%	CPI + 0.99%
Variable rate payment from counterparty	CPI + 0.99%	CPI + 0.99%
Fixed rate payment to counterparty	3.88%	3.90%
Synthetic fixed rate on bonds	3.88%	3.90%

*Fair value* – As of June 30, 2007, the approximate fair market value of these swaps is positive \$520,000. It is the Trust's policy to disclose the dealer's valuation, and to verify the valuation using a swap advisor. This valuation was calculated using the zero-coupon method. This method calculates the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement of the swap.

*Credit risk* – As of June 30, 2007, the Trust was exposed to credit risk because the swaps carried a positive valuation of \$520,000. The swap counterparty is guaranteed by The Bear Stearns Companies Inc, which was rated A+/A1/A+ by Standard & Poor's, Moody's Investors Service, and Fitch

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Ratings, respectively, but Standard & Poor's subsequently downgraded to A. To mitigate credit risk, the Trust has the right to terminate the swap upon a ratings downgrade by the counterparty's credit support provider below BBB-/Baa4 by Standard & Poor's, and Moody's Investors Service, respectively.

*Basis risk* – As of June 30, 2007, the Trust is not exposed to basis risk, as the variable rate payable by the Trust on its bonds is exactly equal to the variable rate payment by the counterparty to the Trust, CPI + 0.99%.

*Termination risk* – The swap contract uses the International Swap Dealers Association Master Agreement, which includes standard termination events, such as failure to pay and bankruptcy. In addition, the Trust may terminate upon a ratings downgrade by the counterparty, as described above. The Trust and the counterparty may terminate if either party fails to perform under the terms of the Contract. If at the time of termination, the swap has a negative fair value, the Trust would be liable to the counterparty for a payment equal to the swap's fair value. The source of funds for this payment is from "legally available funds." Legally available funds is defined as, "funds held in the Trusts Federal Clean Water State Revolving Fund or Drinking Water State Revolving Fund...only to the extent that Congress passes a law or EPA adopts a regulation or issues an opinion or other notice...making such amounts legally available to pay settlement amounts..."



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*Swap payments and associated debt.* Under these swaps, the variable rate is calculated on August 1 and February 1. As of June 30, 2007, the February 1 calculation was most recent. Assuming this rate remains the same, debt service requirements of the variable rate debt and net swap payments are as follows. As the CPI varies, variable rate bond interest payments and net swap payments will vary, but because the variable rate payments on the bonds and the variable rate receipts from the swap are equal, the net debt service will remain fixed.

	<b>Variable rate bonds*</b>		<b>Net swap payments</b>	<b>Total</b>
	<b>Principal</b>	<b>Interest</b>		
Fiscal year ending June 30:				
2008	\$ —	—	—	—
2009	—	2,289,838	716,977	3,006,815
2010	—	2,289,838	716,977	3,006,815
2011	—	2,289,838	716,977	3,006,815
2012	—	2,289,838	716,977	3,006,815
2013	—	2,289,838	716,977	3,006,815
2014	—	2,289,838	716,977	3,006,815
2015	—	2,289,838	716,977	3,006,815
2016	—	2,289,838	716,977	3,006,815
2017	—	2,289,838	716,977	3,006,815
2018	—	2,289,838	716,977	3,006,815
2019	—	2,289,838	716,977	3,006,815
2020	—	2,289,838	716,977	3,006,815
2021	—	2,289,838	716,977	3,006,815
2022	—	2,289,838	716,977	3,006,815
2023	30,650,000	1,835,605	576,600	33,062,205
2024	46,605,000	690,686	218,111	47,513,797

\* Rate as of February 1, 2007, the last reset of fiscal 2007.

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**(10) Policy Revision**

In November 2005, the Trust issued \$293,760,000 of Massachusetts Water Pollution Abatement Trust Pool Program Bonds, Series 11. In conjunction with this bond issue, the Trust revised its bond resolution and standard loan and bond purchase agreements substantially. The purpose of these revisions was to separate the cash flows and security of the Series 11 loan portfolio from the Series 11 bonds. This provides more flexibility to the Trust and its borrowers while making the program easier to account and budget for. Below is a summary of the principal changes to the credit structure.

- a) *Elimination of Matched Book Requirement.* Prior to this change, the Trust was required to carry a “matched book” where principal, interest, and subsidies within the loan portfolio perfectly matched principal, interest, and subsidies within the bond portfolio. This resulted in cumbersome accounting and budgeting requirements for both the Trust and its borrowers. Beginning with the Series 11 bonds, the Trust will be required to show sufficiency of aggregate cash flows necessary to repay the bonds.
- b) *Par Loan Structure.* All loans will be made at a par amount equal to the amount borrowed. Prior to Series 11, any bond premium realized by the Trust was passed through to the communities as a grant, which then reduced the par amount of the loan. As a result of this change, in fiscal 2006, grant disbursements by the Trust were eliminated, compared to \$20.8 million in fiscal 2005.
- c) *Elimination of Gross Pledge.* Communities now are required to provide a pledge equal to the amount of principal and interest due to the Trust, net of subsidies by the Trust and the Commonwealth. Prior to this change, communities were required to pledge the gross amount of the loan at a rate equal to the rate paid by the Trust on its bonds. This eases the accounting and budgeting requirements for the borrowers.

**(11) Subsequent Events**

In December 2007, the Trust expects to issue \$352,320,000 of Pool Program Bonds, Series 13. These bonds will be issued to fund 109 loans in the Clean Water, Safe Drinking Water, and Community Septic Management (Title V) programs.